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**UG-\_\_ – Total Compensation Testimony**

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**I. Introduction & Summary**

**Q. Please state your name and position at NW Natural.**

A. My name is Lea Anne Doolittle. My title is Vice President of Human Resources.  
My qualifications appear at the end of my testimony.

**Q. What is the purpose of your testimony?**

A. The purpose of my testimony is to describe the company's total compensation approach and to provide support for recovery of the costs of the company's total compensation package. I also describe recent changes to NW Natural's total compensation package.

**Q. How is your testimony organized?**

A. I will begin by explaining the company's total compensation philosophy to provide background for my testimony. I will discuss specific components of the total compensation package, including health and pension benefits. I provide support for the costs of both the health and pension benefits.

**II. Total Compensation Approach**

**Q. What is NW Natural's approach to total compensation?**

A. The company's policy is to provide total compensation for labor at desired performance levels which is equal to the average, or median, compensation provided by our competitors. NW Natural does this in order to attract, retain and motivate qualified employees who will perform well. When performance is less than desired, employees should make slightly less than the average compensation, and when performance is better than desired levels, employees should earn slightly more than average compensation. The company's general objective is to

1 provide the same components in our total compensation package that are included  
2 in our competitors' compensation packages. These components generally consist  
3 of base salary, short and long-term incentives, and health, welfare and pension  
4 benefits. In the case of senior management personnel, the use of long-term  
5 incentives as part of the compensation packages by competitors is more prevalent.

6 **Q. How does NW Natural know that its total compensation package is at the**  
7 **“median” level?**

8 A. NW Natural periodically hires consultants to analyze the competitive total  
9 compensation levels and practices of firms with which we likely compete for non-  
10 bargaining unit employees. The company does this to evaluate the structure and  
11 level of our cash compensation and benefits practices when compared to similarly  
12 situated businesses. A similar study for bargaining unit employees is completed  
13 prior to union negotiations.

14 **III. Health Care Benefits**

15 **Q. Have the costs of any individual elements of a total compensation package**  
16 **changed since 1999, the company's last test year?**

17 A. Yes.

18 **Q. Which components have seen the most significant changes?**

19 A. Health care and pension expenses are the two most rapidly changing elements of  
20 compensation. In terms of cost increases, health care costs are experiencing the  
21 most dramatic increases. These increases require attention because of their size  
22 and because of the importance of medical benefits both to employees and to the  
23 company. Health insurance costs include medical, dental, and pharmacy.

1 **Q. Why do health insurance costs require attention?**

2 A. Providing a competitive medical benefit for employees of NW Natural is a base  
3 requirement for NW Natural to be in a position to attract and retain a skilled,  
4 reliable work force. The quality of the medical benefit is also important in  
5 providing employees access to good care which assures timely medical treatment  
6 of illness or injury that, if untimely or untreated, would result in more serious  
7 conditions, higher claims costs, and higher absentee rates. In addition, customers  
8 depend on safe, efficient, and reliable service that a healthy and attentive  
9 workforce provides.

10 **Q. What has been happening to the company's health insurance costs?**

11 A. Medical plan renewal costs have been increasing sharply. Over the past several  
12 years, NW Natural has experienced percentage increases in renewal costs similar  
13 to those being experienced by other companies both in our region and nationally.  
14 This trend has varied from a low of eight percent for medical coverage alone to  
15 fifty percent when including all of the components of health care (medical, dental,  
16 and pharmacy). The cost of health care is also impacted by a company's  
17 medically insured employee population and their demographics. *Exhibit No.*  
18 *\_\_\_\_ (LAD-2)* shows the trend in health care cost. For NW Natural, the trend has  
19 varied from eleven percent to twenty- seven percent since 1999, as seen in *Exhibit*  
20 *No. \_\_\_\_ (LAD-3)*. The upward trend of the medical consumer price index  
21 (MCPI) is expected to continue for the next several years. Towers Perrin, an  
22 international compensation and benefits consulting firm, completed a national  
23 study in September 2003, which indicated that health care will have increased

1 sixteen percent on average in 2003, and projected an increase of 12% in 2004 as  
2 provided in *Exhibit No. \_\_\_\_ (LAD-4)*. Because of this, NW Natural's medical  
3 benefit costs for current employees are expected to rise from a \$11.9 million  
4 annual expense in 2003 to a \$12.8 million annual expense in 2004.

5 **Q. What steps has NW Natural taken to manage and mitigate its increases in**  
6 **health insurance costs?**

7 A. NW Natural is committed to maintaining good quality medical benefits and is  
8 equally committed to assuring efficient and cost-effective delivery of these  
9 benefits. To that end the company has designed its non-bargaining employees'  
10 benefit to include such cost-effective elements as the Kaiser Health Plan, which is  
11 an efficient and unique closed system Health Management Organization (HMO),  
12 as well as a preferred provider organization (PPO), an organization of physicians  
13 offering discounted services. Although the company does not have unilateral  
14 control over the design of the bargaining employee's health plan, it does  
15 encourage the same design in its approach to bargaining unit medical benefits.  
16 The company also offers a mail order prescription drug plan that is less costly and  
17 more efficient than over-the-counter pharmacies.

18 **Q. What additional features of the health plan design help in managing**  
19 **increasing costs?**

20 A. In addition to designing and promoting cost-effective health care packages, the  
21 company, like its competitors, has instituted medical cost sharing with its non-  
22 bargaining unit employees. For many years, these employees have paid an  
23 increasing portion of their own health care costs; the portion varies depending on

1 which plan they select. Because the company's contribution toward the medical  
2 premium does not cover one hundred percent of premium costs, employees pay  
3 the uncovered portion via payroll deduction from their salaries.

4 The portion of health care costs shared with NBU employees has grown  
5 over the years, with the last increase in employee contributions going into effect  
6 for 2004. A composite (average premium) study of NW Natural's  
7 employee/employer premium contributions over the last eight years is provided in  
8 *Exhibit No. \_\_\_\_ (LAD-5)*. This premium cost-sharing ratio is at 14.4% employee  
9 contribution and 85.6% by the employer.

10 In the case of BU employees, only minimal cost sharing is currently in  
11 effect given that the BU labor agreement was last negotiated nearly seven years  
12 ago, in early 1997. There are small deductibles for BU employees as well as co-  
13 pay requirements. At the time of the last negotiation, the unionized employees  
14 pushed hard for maintenance of benefits and were willing to give back on other  
15 items such as increased productivity. Additionally, the Medical Consumer Price  
16 Index had been between 0 and 5 percent for several years preceding negotiations.

17 While some of the increases in medical cost can be softened by offering  
18 more cost-effective programs and requiring cost sharing with employees, both of  
19 these approaches have limits. Only a fixed range of programs are available,  
20 consistent with quality care; too great a level of cost sharing (or low quality  
21 programs) threaten the competitive value of the total compensation package and  
22 thereby the company's ability to acquire and retain skilled and qualified  
23 personnel.

1 **Q. Why has the company experienced such large increases in health insurance**  
2 **costs?**

3 A. Health care costs have been and continue to be one of the most rapidly increasing  
4 elements in the realm of consumer products and services. These cost increases  
5 are not, therefore, unique to NW Natural. They plague businesses across the  
6 economy. The company does, however, have certain characteristics which may  
7 contribute to greater than average cost escalation. NW Natural is a relatively  
8 small company with an average age of 46 for active employees. The average age  
9 of the population receiving health benefits (active and retirees) is 55. A higher  
10 average age within a small pool has resulted in poor health experience and higher  
11 risk. The company cannot offer the demographic mix needed to dilute insurer  
12 risks. This tends to raise premiums. The company's older employee pool tends to  
13 experience a higher rate of health problems than would a younger mix, and this,  
14 too, tends to result in higher than average health premiums than the average  
15 company.

16 **Q. What specific health care costs are expected in the test period?**

17 A. The test period ends on June 30, 2003, and this is prior to the most recent increase  
18 in medical costs for our bargaining unit employees. The latest increase for this  
19 employee group went into effect on July 1, 2003. In addition, the company  
20 already knows what the increase for the non-bargaining unit employees will be  
21 effective January 1, 2004.

1 Because these costs are known and measurable, the company believes these most  
2 recent costs should be included in the test year expense. These expenses are  
3 \$12.8 million.

4 **IV. Pension Benefits**

5 **Q. You mentioned earlier that pension expenses were one of two categories of a**  
6 **total compensation package for which expenses are significantly increasing.**  
7 **Please describe the changes experienced in pension expenses.**

8 A. While the structure of the company's pension benefit and the number of  
9 employees has not changed in the last few years, the value of the assets devoted to  
10 funding those costs has changed significantly. For several years the company's  
11 pension fund has been earning returns that exceeded the projected benefit  
12 obligation. Thus, it has not been necessary for the company to contribute to the  
13 fund from operating revenue. A portion of these excess FAS-87 pension earnings  
14 have been credited against operating expenses and thereby provided rate benefits  
15 to our customers in the company's last general rate case filing, UG-000073. The  
16 specific amount credited was \$132,000. The downturn in the equities market  
17 since mid-2000, however, has resulted in a significant decrease in fund assets,  
18 effectively eliminating the pension fund surplus.

19 NW Natural will experience FAS-87 expenses to meet the pension  
20 obligations. This situation appears to be true on average for all defined benefit  
21 plans nationally. My exhibit contains several articles from major publications,  
22 which stress the impact of pension funding problems due to the downturn in the  
23 market. *See, Exhibit No. \_\_\_\_ (LAD-6).* As a result of the market deterioration



1 and its impact on the company's pension obligation, NW Natural's actuarial  
2 consultant has reported that it will be necessary for the company to begin  
3 expensing these benefit obligations. While a market recovery could return some  
4 of the losses, the scope of the collapse in market values suggests that a complete  
5 recovery will take considerable time.

6 **Q. What actions has NW Natural taken to minimize these pension losses?**

7 A. The company's pension fund investment performance has performed well above  
8 average over the long term. The company has an oversight committee of  
9 corporate officers that sets the asset allocation and investment policy for the  
10 pension fund and monitors the fund performance. They are assisted by R.V.  
11 Kuhns, a professional retirement fund consulting firm. Records provided by the  
12 consulting firm indicate that the fund has performed in the top 20th percentile of a  
13 universe of peers over 7- and 10-year trailing periods as of June 30, 2003, and has  
14 outperformed the median universe return six out of the 10 most recent calendar  
15 year periods. The Independent Consultants Cooperative Universe from which the  
16 comparisons were drawn is compiled by Deutsche Bank on a quarterly basis and  
17 is utilized by prominent clients and organizations across the country, as provided  
18 in *Exhibit No. \_\_\_\_ (LAD-7)*. As *Exhibit No. \_\_\_\_ (LAD-8)* demonstrates, NW  
19 Natural has a history of maintaining a diverse portfolio of asset allocation that is  
20 well balanced between fixed income and growth and value equity. The portfolio  
21 mix has not varied much from the median plan asset allocation in its long history,  
22 which attests to the prudence of the company's retirement committee and its  
23 advisors.

1 **Q. How did the company develop its projected pension costs for the test period?**

2 A. The company used actual pension costs for 2003 and projections of pension costs  
3 developed by its actuarial service, Buck Consultants, for 2004 and 2005. The  
4 pension costs and asset values were determined using assumptions as to the  
5 discount rate and the return to pension fund assets. The assumptions were  
6 determined using the guidance provided by our actuary and  
7 PriceWaterhouseCoopers, by the Retirement Committee of the company as part of  
8 their fiduciary responsibilities. For the present filing, the committee has chosen a  
9 discount rate of 6.75% for 2003 and 6.50% for 2004 and 2005. The level of fund  
10 earnings is 8.0%. The resulting FAS-87 expense for 2003 was \$6.25 million. The  
11 company has also received from Buck Consultants the estimated FAS-87  
12 expenses for 2004 of \$6.92 million and 2005 of \$7.76 million, as shown in  
13 *Exhibit No. \_\_\_\_ (LAD-9)*. Because the 2004 FAS-87 expenses are known, we are  
14 showing these expenses of \$6.92 million for the test year expense in *Exhibit No.*  
15 *\_\_\_\_ (KSM-1)*.

16 **Q. How does the company propose to include these costs for rate case purposes?**

17 A. The company proposes to include estimated pension administration and FAS-87  
18 expenses for the period through December 2004. In past rate cases, the company  
19 has used an average of three years of pension administrative and general and  
20 FAS-87 costs, but believes this method is no longer necessary. The use of the  
21 three-year average was intended to “smooth” fluctuations in FAS-87 expense.  
22 But, in fact, the annual figures which are averaged in this rate case method are  
23 themselves averages of three years of experience. There is no need to “double

1 smooth” the FAS-87 results; the averaging already performed by the company  
2 sufficiently moderates these expenses for rate case purposes.

3 **V. Qualifications**

4 **Q. Please describe your education and employment background.**

5 A. I received a Masters Degree in Management (Business) from The Atkinson  
6 School at Willamette University in 1980 and a Bachelors degree in Sociology  
7 from the University of Redlands in 1977. I have worked for NW Natural in my  
8 current role since October of 2000. Prior to NW Natural, PacifiCorp employed  
9 me for 10 years as the Director of Compensation and in other human resource  
10 management roles. Before joining PacifiCorp, I was the Director of Human  
11 Resources and Compensation for eight years at NERCO.

12 **Q. What are your responsibilities with NW Natural?**

13 A. I am responsible for overseeing all of the Human Resource functions for NW  
14 Natural including staffing, compensation and benefits, employee training and  
15 organization development, employee relations and payroll.

16 **Q. Does this conclude your testimony?**

17 A. Yes.